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BEFORE THE ARIZONA CORPORATION COMMISSION

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KRISTIN K. MAYES - CHAIRMAN
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

IN THE MATTER OF THE APPLICATION OF RIO RICO UTILITIES, INC., AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS WATER AND WASTEWATER RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.

DOCKET NO. WS-02676A-09-0257

NOTICE OF FILING

Rio Rico Properties, Inc., through undersigned counsel, hereby files the Direct Testimony of Matthew Rowell regarding rate design.

RESPECTFULLY SUBMITTED this 14th day of January 2010.

ROSHKA DEWULF & PATTEN, PLC

Arizona Corporation Commission
DOCKETED
JAN 14 2010
DOCKETED BY

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Direct Testimony of

Matthew J. Rowell

on Behalf of

Rio Rico Properties, Inc.

January 14, 2010

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I. INTRODUCTION.

Q. Please state your name and business address.

A. My name is Matthew Rowell. My business address is 9808 South 45th Place, Phoenix, Arizona.

Q. By whom are you employed and what are your duties and responsibilities?

A. I am a member of Desert Mountain Analytical Services ("DMAS") a consulting firm specializing in utility regulatory matters. In that capacity I have provided testimony regarding various utility regulatory issues before the Arizona Corporation Commission ("Commission").

Q. Please state your background and qualifications in the field of utility regulation.

A. A statement of my qualifications is attached as Exhibit 1 to this testimony.

Q. What is the purpose of your testimony?

A. I am providing testimony on behalf of Avatar Holdings and Rio Rico Properties ("Avatar"). Avatar owns substantial real estate that is in various stages of development within Rio Rico Utilities Inc's ("Company") certificated area. My testimony is limited to addressing Avatar's issues with the Company's proposed hook up fee ("HUF") tariff.

Q. What differences are there between the Company's proposed water and wastewater hook-up tariffs?

A. According to the Company, other than the amounts, there are no material differences between these tariffs.[1] Accordingly, my testimony addresses both tariffs jointly.

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[1] Company Response to Avatar Data Request 2.15.

II. OVERVIEW AND PURPOSE OF HUFS.

Q. Please provide some background on the purpose of HUFs.

A. For ratemaking purposes, funds received through HUFs are treated as contributions in aid of construction ("CIAC".) Like all contributions, HUFs are intended to fund the utility's investment in plant, not the utility's operating expenses. Funds used for the extension of mains to a particular developing area are typically provided through a main extension agreement and are treated (per A.A.C. R14-2-406) as advances in aid of construction ("AIAC.") This plant needed to extend service to a particular developing area is referred to as "on-site" plant. In contrast, "off-site" plant is plant needed to increase the capacity of the system as a whole (such as new wells for a water company or new or expanded wastewater treatment plants for a wastewater company.) Contributions are intended to fund a portion of this offsite plant. That is, typically, CIAC is used to fund off-site plant and AIAC is used for on-site plant.

Q. Does the Arizona Administrative Code contain any rules regarding HUFs?

A. No. A.A.C. R14-2-406 provides explicit directions on how main extension agreements shall be conducted. On the subject of HUFs, however, the rules are silent. Additionally, HUFs are not subject to negotiation as main extension agreements are. The Commission has accepted HUFs in some instances and they are recognized as an appropriate means to raise some of the funds necessary for a needed expansion in capacity. However, since HUFs are covered only in a utility's tariff, the language contained in a company's HUF tariff is extremely important. Ambiguous language in the tariff could be detrimental to the utility, its customers and/or developers operating in the utility's service territory.

Q. What is the regulatory justification for HUFs?

A. Until 10-15 years ago, the Commission rarely approved HUFs.[2] More recently, the Commission has accepted HUFs in some instances. Typically, the Commission's support is based on the concept of "growth paying for growth." Or as the Company states, "[h]ook-up fee funds are for new capacity required to provide service."[3] Thus, HUFs may be appropriate where growth is causing the utility to make capital investments for off-site capacity. Conversely, in situations where the utility has existing capacity, or existing obligations to provide capacity, a HUF is not justified.

Excessive reliance on HUFs or other sources of developer capital can result in financial weakness for the utility.[4] However, HUFs do provide some advantages. By providing a set amount, they prevent possible disagreements over developer responsibilities for off-site infrastructure. In order to realize this advantage, however, the HUF tariff must be clear and potential ambiguities or sources of dispute eliminated.

III. <u>THE COMPANY'S PROPOSED HUF TARIFFS.</u>

Q. What is Staff's position concerning the Company's requested HUFs tariffs?

A. According to Staff witness Gerald W. Becker, Staff recommends disapproval because the "Company refused to provide support" for the HUF tariff in response to Staff data requests.[5]

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[2] Interim Report of the Arizona Corporation Commission's Water Task Force, dated October 28, 1999) at p. 16 (Docket No. W-00000C-98-0153).

[3] Company Response to Avatar Data Request 2.3.b.

[4] *See e.g.* Decision No. 71414 (December 8, 2009) at 8-10 (describing problems associated with excessive use of HUFs).

[5] Direct Testimony of Gerald W. Becker (Rate Design) filed January 6, 2010 at 3,6.

Q. What is your response to Staff's testimony?

A. I agree with Staff that the Company's proposed HUF tariff should be denied unless the Company provides support for its proposal.

Q. Did Staff make other relevant findings?

A. Yes, Staff engineer Jian W. Liu reports that the Company has adequate capacity to "serve the existing customer base and reasonable growth."[6] If this finding is correct, it would call into doubt the need for the HUF tariff because the purpose of HUFs is to pay for additional off-site capacity. Any issues concerning the Company's capacity needs should be resolved before a HUF is approved.

Q. Does Avatar have concerns beyond those expressed by Staff?

A. Yes. The original tariffs filed with the Company's rate case contained ambiguous language that was a concern. At several points, those proposed tariffs reference additional payments that may be required from the applicant.[7] These ambiguous references to potential additional payments create an environment of uncertainty that makes planning for development unnecessarily difficult. I understand that the Company will be filing revised tariffs similar to those filed by its affiliate Litchfield Park Service Company (LPSCO) on December 31, 2009 in Docket Nos. SW-01428A-09-0103. The LPSCO HUF fee tariffs appear to eliminate these references to additional payments. If the Company files similar tariffs, it would be an improvement, but Avatar believes that additional clarity on the issue of potential additional payments is necessary. Further it appears that the scope of the proposed tariffs is overly broad. In their current form the proposed tariffs appear to require HUFs in instances when additional offsite facilities are

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[6] Direct Testimony of Jian W. Liu, December 15, 2009, at 4:7-8 and 5:14-15.

[7] The Company's proposed water division HUF tariff defines "applicant" as "any party entering into an agreement with Company for the installation of water facilities to serve new service connections, and may include Developers and/or Builders of new residential subdivisions and/or commercial and industrial properties."

not necessary. Should the Company continue to pursue the filed HUF tariffs and not submit revised tariffs that are similar to the revised LPSCO tariffs, I will provide additional comments and concerns in my surrebuttal testimony on the ambiguous and overbroad of the currently proposed HUF tariffs.

Q. You stated above that additional clarity on the issue of potential additional payments is necessary. Please explain.

A. The HUF tariffs filed by LPSCO eliminate the explicit references to potential additional payments but they do not explicitly state that there will be no additional contributions required by the applicant. In order to provide certainty and clarity on this issue, Avatar believes the tariffs should contain a specific statement that the amount due under the HUF tariffs (and any applicable charges for on-site facilities under Line or Main Extension Agreements) is the total amount due from the applicant and that no additional charges will be assessed.

I have also seen proposed main extension agreements from LPSCO (these were provided in the pending LPSCO rate case as exhibits to intervenor testimony) that appeared to include a "capacity" charge in addition to the HUFs. Given the purpose of HUFs, that suggests a potential double recovery depending on how such provisions are interpreted. The potential for such "capacity" charges to appear in main extension agreements is an additional reason why the HUF tariff should clearly indicate that the amount due under the HUF tariffs (and any applicable charges for *on-site* facilities under Line or Main Extension Agreements) is the total amount due from the applicant and that no additional charges will be assessed.

Q. Did Company provide additional information on the potential additional payments?

A. Yes, in response to Avatar Data Requests 2.17 and 2.18, Company refused to give any assurance additional payments would not be required. Company indicated that "[a]dditional financing may be required pursuant to the Commission's main extension rules" even for off-site facilities. This language appears to indicate that Company believes it can charge additional amounts for off-site facilities over and above any HUFs. Such a practice would be inconsistent with the Commission's historical practice concerning HUFs. If other developer funds are required for off-site investments, why have a HUF? In addition, this possibility eliminates the clarity and ease of administration that are some of the major benefits of HUFs. If the Commission approves a HUF, the Commission should expressly state that the HUFs are the sole source of developer or landowner funding for off-site infrastructure.

Q. **You also stated above that the scope of the above tariffs may be overly broad. Please explain.**

A. As written the proposed tariffs would potentially apply in subdivisions where there is already a Main Extension Agreement in place, subdivisions where Company is already providing service and subdivisions where Company has accepted on-sites.

Q. **Why is that a problem?**

A. In each of the above instances capacity to serve the relevant subdivision should already be in place and thus there should be no need for additional payments to fund capacity expansion.

Q. **What does Avatar propose regarding this issue?**

A. Specific language should be added to the proposed tariffs that clearly indicates that the HUFs will not apply to subdivisions that satisfy any of the following conditions at the time the HUF tariffs are approved by the Commission:

- a Main Extension Agreement is in place for the subdivision,

- Company is already providing service in the subdivision,
- Company had accepted on-sites in the subdivision.

Q. Does the Company agree with Avatar that the HUFs should not apply in subdivisions where an MXA is already in place?

A. Yes. In response to Avatar Data Request 2.22, Company indicates that it does not intend for the hook-up to apply to subdivisions for which there is already a main extension agreement in place. Thus, adding specific language to that effect to the tariffs should not be controversial.

Q. Does the Company agree with Avatar that the HUFs should not apply in subdivisions where Company is already providing service?

A. In response to Avatar Data Request 2.23, the Company indicated that within such a subdivision lots covered by a Main Extension Agreement would not be subject to the HUFs but lots not covered by a Main Extension Agreement will be subject to the HUFs. Avatar disagrees with the Company on this point and believes the HUFs should not apply to any lot within a subdivision where service is already being provided.

Q. Does the Company agree with Avatar that the HUFs should not apply in subdivisions where Company has accepted on-sites?

A. The Company's response to Avatar Data Request 2.24 indicates that the Company agrees that HUFs should not apply in subdivisions where the Company has accepted on-sites subject to a Main Extension Agreement but they should apply absent a Main Extension Agreement.

Q. Do you have any other comments on HUFs?

A. Yes. Assuming the Staff recommendation is not accepted, the HUF should have a provision that expressly provides for an offset against the HUF for any developer-provided off-site facilities, including water production capacity or wastewater treatment capacity. For example, if a developer turns over a well to the Company, the value of that well should reduce the amount of HUFs the developer needs to pay.

Q. Please summarize your recommendations.

A. A HUF should not be approved until the Company provides adequate documentation to Staff supporting the need for a HUF. If a HUF is approved, it should provide that HUFs are the sole source of developer or landowner funding for off-site infrastructure. In addition, if a HUF is approved, it should not apply where (at the time the HUF is approved): (1) a main extension agreement has been executed for the subdivision; (2) the Company has started providing service to the subdivision; or (3) the Company has accepted on-site facilities within the subdivision. There should also be a provision that allows an offset where a developer provides offsite facilities, including production or treatment capacity, to the Company.